Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
	)	
High Cost Universal Service Support	)	WC Docket 05-337
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
Lifeline and Link Up	)	WC Docket No. 03-109

COMMENTS OF SUREWEST COMMUNICATIONS

Paul J. Feldman, Esq.
Fletcher, Heald and Hildreth PLC
1300 North 17th St., 11th Floor
Arlington, Virginia 22209
(703) 812-0400

April 18, 2011

TABLE OF CONTENT

SUMMARY

In these Comments, SureWest Communications notes that the construction and maintenance of advanced broadband ILEC networks is critical to the accomplishment of the Commission's goals in the National Broadband Plan. However, proposals in the *NPRM* to shift all of the cost recovery necessary for such networks onto terminating end users, without some alternate recovery mechanism, is contrary to the public interest. SureWest also shows that the Commission has unique responsibilities towards rate-of-return companies in the process of revising the USF/intercarrier compensation ("ICC") regime.

The quality, stability and maintenance of the wireline network is critical to accomplishing the goal of universal access to broadband. First, ILECs act as a carrier of last resort ("COLR") for millions of subscribers. In such cases, the quality of the wireline network is essential to providing robust broadband services to the subscriber. Second, the ILEC wireline network is often relied upon by <u>other</u> providers of broadband service, such as CLECs and VOIP providers, in order to reach their customers.

As it moves forward in this proceeding, the Commission should recognize that its actions will have real impacts on networks. Significant shifts in rates and cost recovery will impair the investment that real companies make in maintaining and expanding their networks, and that correlation directly impacts the public interest. First, significant reduction or elimination of USF and ICC for many carriers without replacement (as proposed in the *NPRM*) will directly reduce the amount of money that carriers can direct towards construction and maintenance of the network, threatening connectivity in areas that need it most. Further, a carrier's access to capital to be used for investment in the network can be harmed as a result of a reduction in cost recovery through USF or ICC.

In light of the significant impacts that ICC/USF reform will have on carriers and subscribers, SureWest urges the Commission to be mindful of the following principles in enacting such reform:

1. <u>Large shifts of cost recovery onto terminating end users is contrary to the public interest</u>. Essentially, the Commission is proposing significant end user rate increases that likely will be detrimental to the universal broadband penetration goals of the National Broadband Plan. While federal subsidies such as Lifeline provide some support to low income subscribers, that subsidy is under-utilized by eligible households. Significant rate hikes will likely result in additional households dropping off the PSTN and the broadband network. Alternatively, when subscribers see price increases from subscriber line charges, they will look around to find providers who do not charge SLCs and thus can offer lower priced service. Typically, that would be VOIP providers, whose network capital and operational costs are usually lower than those of wireline LECs. But regulatory policies that artificially push customers away from ILECs would further undercut the ability of the LECs to support the PSTN during the transition to the advanced broadband network, and after the transition will undercut the ability to build out and maintain that advanced broadband network. This would be contrary to the

interests of subscribers and of other carriers that rely on the ILEC network, and thus would be contrary to the public interest.

2. If the Commission significantly reduces ICC, rather than shifting that lost cost recovery to terminating end users, there must be an alternative recovery mechanism ("RM"), at least during the transition to the advanced broadband network. The RM must not be limited just to carriers that operate in "unserved" areas, since the proposed changes to USF and ICC will significantly impact the ability of most LECs to construct and maintain the wireline network, not just those LECs that operate in "unserved" areas, however defined by the Commission. An RM should not be allocated pursuant to competitive bidding. The purpose of an RM would be to replace, for the COLRs that are building and maintaining the wireline network, at least some of the cost recovery lost by the proposed reforms to ICC and USF. Making the RM available through competitive bidding, to carriers that depend (at least in part) on the underlying wireline provider, rather than directly to that underlying carrier itself, would defeat the purpose of the RM. Rather, the RM should be made available on a right of first refusal basis to COLRs.

3. The speed of any transition should be moderate, in order to assure that networks are not adversely harmed and customers are not saddled with unexpected and harmful outcomes. The breadth and depth of impact on networks and subscribers proposed in the *NPRM* is significantly greater than that which the Commission created by enacting Subscriber Plant Factor changes and the CALLS Plan, and accordingly a transition period of 7 to 10 years will be necessary.

In this proceeding, the Commission must also consider its unique responsibilities to rate-of-return ("ROR") carriers. While the majority of ILEC access lines are held by price-cap carriers, the majority of ILECs are regulated under ROR. These carriers are typically smaller, more reliant on regulated revenues, and thus more economically vulnerable to rapid and substantial shifts in regulation of their rates. The current state of federal law anticipates that the Commission must afford rate of return carriers a realistic opportunity for cost recovery. It does not require a guarantee, but under the *AT&T v FCC* case, the Commission cannot reduce ICC rates in a manner that creates "systematic underearnings" that would necessarily result for ROR carriers absent alternative cost recovery accommodations. Further, the Commission should be mindful that it may not simply determine ICC rates, and for ROR carriers their authorized rates-of-return, through the present rulemaking proceeding. Under Section 205 of the Communications Act, the Commission may prescribe a rate only in a re-prescription hearing, where it is determined that the rate to be prescribed will be "just and reasonable".

When the Commission determines whether rates filed with it are just and reasonable, it is costs that are generally the principal points of reference. The law is clear: an ROR carrier must be permitted to charge rates that allow it to recover costs, along with a reasonable rate of return on its invested capital. If, however, the Commission chooses to base ICC on the recovery of revenues, then it should also be careful not to "cheat" – that is, to take into account for regulated cost recovery purposes the non-regulated revenues and non-jurisdictional revenues that it has always prohibited from commingling for other purposes.

ICC rates must be rationally based on data and models. Unfortunately, some parties have called for an ICC rate level of $0.0007 cents per minute, although that rate is a scarcely-justified figure that has never been identified as the rate actually needed for ROR carriers (or others) to recover their costs. The original adoption of $0.0007 was a reflection of a single interconnection agreement at a single point in time, namely, Level 3's interconnection agreement with SBC for 2002. As Level 3 and SBC have no resemblance to ROR carriers, the $0.0007 rate has no obvious or apparent applicability to ROR cost recovery requirements.

The Commission has previously created interstate common line support ("ICLS") to provide a critical role in allowing carriers to recover costs while keeping rates as close as possible to being cost-based. Accordingly, the Commission should act carefully in fitting ICLS into its on-going USF policies, both during the transition to and after the full implementation of the CAF. Specifically, while it may be reasonable to cap the current level of ICLS, such capping should be on a dollar basis per study area, not on a per-line basis. It is important to recognize that while traditional access lines may be declining, the common line costs in fulfilling the COLR obligation to provide service to the existing subscribers does not go down incrementally on a per-line basis. Accordingly, the cost recovery mechanism of ICLS should not be capped in that manner. Similarly, caps for application of ICLS to operating expenses and capital expenses should also be on a dollar basis per study area.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates	)	WC Docket No. 07-135
for Local Exchange Carriers	)	
	)	
High Cost Universal Service Support	)	WC Docket 05-337
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Lifeline and Link Up	)	WC Docket No. 03-109

COMMENTS OF
SUREWEST COMMUNICATIONS

SureWest Communications, by its attorneys, hereby submits these Comments in response to the Commission's Notice of Proposed Rulemaking in the above-captioned proceedings, released February 9, 2011 ("*NPRM*"). In these Comments, SureWest notes that the construction and maintenance of advanced broadband networks is critical to the accomplishment of the Commission's goals in the National Broadband Plan. However, proposals in the *NPRM* to shift all of the cost recovery necessary for such networks onto terminating end users, without some alternate recovery mechanism, is contrary to the public interest. SureWest also shows that the Commission has unique responsibilities towards rate-of-return companies in the process of revising the intercarrier compensation regime.

I. Introduction

SureWest Communications is a holding company whose subsidiaries provide incumbent local exchange, competitive local exchange, interexchange, multichannel IP video, and broadband data services. The SureWest Telephone subsidiary ("SureWest") is an incumbent local exchange carrier ("ILEC") operating solely in California, serving less than 100,000 access lines, and is regulated as a rate-of-return company by the FCC.

Since 1914, SureWest has taken pride in providing high-quality, dependable and affordable services to its customers. As an ILEC, it is the carrier of last resort ("COLR") in its local telephone service area, yet it is faced with multiple competitors for the provision of telephone services (e.g. wireless, cable VOIP, non-facilities/over-the-top VOIP, and other wireline providers) that are not the COLR. Part of taking COLR responsibilities seriously is a commitment to provide service to all customers in a service area and maintaining a high quality network. But maintaining a high quality network ready to provide services to all customers in a service area requires cost recovery resources, including USF and ICC.

II. The Quality, Stability and Maintenance of the Wireline Network is Critical to Accomplishing the Goal of Universal Access to Broadband.

Before considering the specific reforms to universal service programs for which comment is sought in the *NPRM,* it is necessary to keep in mind the overarching goal of this proceeding: "[b]ringing robust, affordable broadband to all Americans…." *NPRM* at para. 1. In seeking to fulfill that goal, the Commission must be mindful of the fact that the wireline network operated by ILECs is a critical component of the nation's broadband network.

First, ILECs act as a carrier of last resort ("COLR") for millions of subscribers. In some cases, there is no other wireline network provider offering service to those subscribers. In such cases, the quality of the wireline network is essential to providing robust broadband services to the subscriber.

Second, the ILEC wireline network is often relied upon by <u>other</u> providers of broadband service, in order to reach their customers. For example CLECs, and over-the-top video and VOIP providers, often interconnect with the ILEC network to directly access their subscribers. Similarly, fixed and mobile broadband providers often rely on portions of the ILEC network for backhaul delivery of traffic. The quality of the ILEC network is thus critical to the ability of <u>other competitors</u> to provide the best possible service to their customers. However, as discussed below, carriers must have sufficient cost recovery to construct and maintain a high quality network.

In addition to facilitating access to affordable broadband, the Commission has also made it a goal that the Nation's broadband network be "world-class."[1] For now and at least for the foreseeable future, only wireline broadband networks such as those operated by ILECs, are robust enough to deliver multiple channels of HD video, as well

[1] *See*, Federal Communications Commission, *Connecting America: The National Broadband Plan* (rel. Mar. 16, 2010), at page 9.

as other bandwidth-rich services consistent with current customer expectations and the goals of the FCC's National Broadband Plan.[2]

In sum, the Commission cannot fulfill its goal of universal access to robust broadband services without well maintained, high quality ILEC networks.

III. Adjustments to USF and ICC Mechanisms Will Have Broad and Real Impacts on Local Wireline Networks and Their Customers.

Each time that the Commission has undertaken a substantial assessment and adjustment of ICC and USF mechanisms, it has recognized the important need to engage in a balancing of many interests. The Commission has always wisely elected to move deliberately, and to implement changes in measured and non-destructive ways -- with an understanding of the impacts on industry segments and on individual carriers.

As it moves forward in this proceeding, the Commission should recognize that its actions will have real impacts on networks and subscribers. USF and ICC reform is not an abstract mathematics exercise of shifting accounts of money on paper. Significant shifts in rates and cost recovery will impair the investment that real companies make in maintaining and expanding their networks, and that correlation directly impacts the public interest.

[2] In connection with the National Broadband Plan, Chairman Genachowski has stated that "[w]e're going to set goals around making sure that every community by 2020 has a 1 gigabit connection at an anchor institution like a school or a library or a healthcare facility." *See,* John Poirier, *U.S. Seeking 1 Gigabit Internet Speed for Communities,* REUTERS, March 4, 2010, *available at* *http://www.reuters.com/article/2010/03/04/us-broadband-fcc-speed-idUSTRE6233NJ20100304* (last visited April 12, 2011). SureWest currently offers a 1 gigabit Ethernet service, and Verizon recently completed a trial on its FiOS network that approached delivery of 1 gigabit. *See,* Jeff Bertolucci, *Verizon FiOS Test Nears 1 Gigabit Per Second*, PC WORLD, August 16, 2010, *available at* *http://www.pcworld.com/article/203390/verizon_fios_test_nears_1_gigabit_per_second.html* (last visited April 12, 2011).

The Commissions' revisions to USF and ICC rules and policies will affect the development of broadband networks in numerous ways. First, the construction and maintenance of advanced broadband networks costs money.[3] USF and ICC are two of the three major sources of cost recovery for many ILECs (the third being end user charges). Significant reduction or elimination of these sources for many carriers without replacement (as proposed in the *NPRM*) will directly reduce the amount of money that carriers can direct towards construction and maintenance of the network, threatening connectivity in areas that need it most.

Second, reduction of USF and ICC cost recovery resources can create pernicious regulatory incentives across the network ecosystem that are contrary to the goals of building the advanced broadband network sought by the Commission. For example, in a recent White Paper to the State members of the Federal-State Joint Board on Universal Service, Loube and Pilalis stated:

> [p]rescribing zero rates for intercarrier compensation can inhibit sufficient investment. To the extent that regulatory policy mandates that carrier A can have access to carrier B's network facilities without paying compensation, regulators create an incentive for all telecommunications and communications service providers to adopt business plans similar to A's rather than B's. Yet if carriers like B must continue to invest to provide adequate facilities and

[3] In its September 29, 2009, presentation, the FCC's staff estimated that the cost of making a universally available advanced broadband network ranges to $350 billion for 100 mbps. A proposed speed in the 1-4 mbps range could cost from $20 to $ 35 billion. *See*, FCC, September Commission Meeting, September 29, 2009, Slide No. 45, *available at* *http://reboot.fcc.gov/open-meetings/2009/september* (last visited April 12, 2011).

> adequate capacity for access services, the result can be insufficient investment and traffic congestion.[4]

Third, a carrier's access to capital to be used for investment in the network can be harmed as a result of a reductions in cost recovery through USF or ICC. In Comments filed previously in some of the above-captioned dockets, the Rural Utilities Service (a major lender to rural LECs) stated:

> A recent analysis of borrowers receiving loans shows that 53% of those loans would not be feasible with frozen USF. If toll revenues are frozen (interstate and intrastate access revenues, interstate and intrastate USF, and end-user SLC charges), *two-thirds of the loans are not feasible*…. The agency is concerned that there is a possibility that certain proposed actions would cause delay or preclude broadband deployment to rural communicates at a time when that investment is needed the most.[5]

Finally, significant reduction in USF and ICC cost recovery mechanisms will also have a real impact on subscribers. As discussed above, to the extent that significant reductions in ICC and USF impact the cash flow necessary for ILECs to properly recover their costs and invest in the expansion and maintenance of the advanced broadband network, it is subscribers who ultimately suffer the consequences of reduced quality of service. More directly though, any costs that cannot be sufficiently recovered from ICC and USF must be recovered from end users. Because the Commission proposes substantial increases in SLCs and end user rates to make up for lost USF and

---

[4] Dr. Robert Loube and Labros E. Pilalis, *Intercarrier Compensation -- A White Paper to the State Members of the Federal-State Joint Board on Universal Service* (Feb. 7, 2011) at page 12, *available at* http://www.kcc.ks.gov/telecom/roundtable032011/Intercarrier_Compensation_White_Paper.pdf (last visited April 12, 2011).

[5] U.S. Department of Agriculture Rural Utilities Service Reply Comments, WC Docket No. 05-337, CC Dockets 96-45 and 01-92 (Dec. 22, 2008) at page 2 (emphasis added).

ICC resources, it is the "terminating" subscribers who will have to take on the increased burden. SureWest is concerned that the resulting increases imposed on terminating end users will hamper the Commission's goal of universal access to the broadband network. SureWest has calculated, based on 2010 financial data, that if interstate and intrastate access rates are reduced to zero, its end user charges would have to be raised approximately $8.50 per line, per month, to make up for the lost cost recovery. Similarly, if the Commission were to eliminate some or all of the interstate common line support ("ICLS"), end user charges would additionally have to be raised up to $7.50 per line, per month, to make up for that lost cost recovery.[6] SureWest believes that the impact would be even greater for smaller carriers that rely more heavily on access charges and ICLS.

Therefore, in enacting reform of ICC and USF, the Commission must be mindful of the real impacts that proposed changes will have on the PSTN, the advanced wireline broadband network, and the subscribers and other carriers that rely on those networks.

IV. Principles for ICC and USF Reform.

In light of the significant impacts that ICC/USF reform will have on carriers and subscribers, SureWest urges the Commission to be mindful of the following principles in enacting such reform.

A. Large Shifts of Cost Recovery Onto Terminating End Users is Contrary to the Public Interest.

Traditionally, ILECs have recovered their costs from three major sources -- USF, ICC and end user charges (retail rates and SLCs). The Commission now proposes that

[6] SureWest's basic flat residential telephone service rate is $19.99 with a SLC of $6.50. Its basic flat business telephone service is $39.85, with a SLC of $6.50 for single line business or $9.20 per line for multiline business customers

for many ILECs, two of those cost recovery mechanisms, ICC and USF, would be eliminated or essentially eliminated. That is, many ILECs not in "unserved" areas would no longer be eligible to receive some or all of their current federal USF, and ICC would be reduced to zero (bill and keep), or a rate so low as to practically be zero.[7] In most such cases, the Commission appears to propose that cost recovery be shifted entirely to the terminating end user, through increases in SLCs and use of rate bench-marks.

However, shifting all of the cost recovery directly onto terminating end users is contrary to the public interest.[8] Essentially, the Commission will be mandating significant end user rate increases that likely will be detrimental to the universal broadband penetration goals of the National Broadband Plan. While federal subsidies such as Lifeline provide some support to low income subscribers, as the Commission well knows, that subsidy is under-utilized by eligible households. Furthermore, Lifeline assistance is not currently available for broadband services, and even if the Commission rules are modified to allow such use,[9] there is no way of predicting whether utilization by eligible households for such services will be any greater than the current level. In the absence of effective utilization of Lifeline, significant rate hikes will likely

---

7 The rate of $0.0007 commonly proposed by some parties may not even cover the cost of collecting payment.

8 Unless the Commission acts to preempt the states and to combine interstate and intrastate intercarrier compensation arrangements, any new scheme that is advanced by the Commission to reallocate cost recovery to terminating end users must be limited to the interstate jurisdiction.

9 *In the Matter of Lifeline and Link Up Reform and Modernization, Federal-State Joint Board on Universal Service, Lifeline and Link Up,* Notice of Proposed Rulemaking, 26 FCC Rcd 2770 (2011).

result in additional households dropping off the PSTN and the broadband network. That would clearly be contrary to the public interest.

Alternatively, when subscribers see price increases from SLCs, they will look around to find providers who do not charge SLCs and thus can offer lower priced service. Such providers would include VOIP providers, for example, whose network capital and operational costs are usually lower than those of wireline LECs. But regulatory policies that artificially push customers away from ILECs would further undercut the ability of the LECs to support the PSTN during the transition to the advanced broadband network, and after the transition will undercut the ability to build out and maintain that advanced broadband network. This would be contrary to the interests of subscribers and of other carriers that rely on the ILEC network, and thus would be contrary to the public interest.[10]

B. If the Commission Significantly Reduces ICC, a Sufficient Recovery Mechanism Will Be Necessary to Support Maintenance of the PSTN and Construction of the Advanced Broadband Network.

It is no secret that significant resources are necessary to maintain the quality of the PSTN, as well to construct and ultimately maintain the quality of the advanced broadband network that will replace the PSTN. As discussed above, this public interest requirement will not be fulfilled by minimizing or eliminating cost recovery from USF and ICC, and shifting all of that cost recovery onto the end user. Accordingly, if the

[10] While SureWest does not endorse significant additional cost recovery from terminating end users, should the Commission take that approach, any local rate benchmark used in connection with ICC should not include non-regulated revenues, as there is great variation among carriers as to the non-regulated services offered, as well as to the charges for those services. As a result, a nationwide benchmark would be inapplicable in many communities, and accordingly would be arbitrary and counter-productive. Furthermore, the Commission cannot recover any regulated costs from services fenced off from Commission regulation by both the Act and the Commission's own rules. *See* Allocation of Costs, 47 CFR 64.901, et. seq.

Commission significantly reduces ICC, rather than shifting that lost cost recovery to end users, there must be an alternative recovery mechanism ("RM"), at least during the transition to the advanced broadband network.

The RM must not be limited just to carriers that operate in "unserved" areas. The proposed changes to USF and ICC will significantly impact the ability of most LECs to construct and maintain the wireline network, not just those LECs that operate in "unserved" areas, however defined by the Commission. Similarly, the minimization or elimination of cost recovery from ICC will apply to all LECs, not just those that operate in "unserved" areas.

While the RM could be part of the proposed Connect America Fund, it should not be allocated pursuant to competitive bidding. The purpose of an RM would be to replace, for the COLRs that are building and maintaining the wireline network, at least some of the cost recovery lost by the proposed reforms to ICC and USF. Making the RM available through competitive bidding, to carriers that depend (at least in part) on the underlying wireline provider, rather than directly to that underlying carrier itself, would defeat the purpose of the RM. Rather, the RM should be made available on a right of first refusal basis to COLRs.

The RM should be considered a cost recovery tool, not a revenue replacement tool. But for rate-of-return ("ROR") carriers, costs are expressed as part of their "revenue requirement." Accordingly, the revenue requirement must be considered in designing an RM for ROR carriers.

C. The Speed of Transitions Should Be Moderate, in Order to Avoid Unnecessary Disruption.

In considering the speed of ICC and USF reform, the *NPRM* states that the Commission intends “to avoid sudden changes or “flash cuts” in [its] policies, acknowledging the benefits of measured transitions that enable stakeholders to adapt to changing circumstances and minimize disruption.” *Id.* at para. 12. SureWest concurs that measured transitions are necessary in order to avoid harmful disruption to the maintenance of the network.

Given the proposals in the *NPRM* to zero out ICC and to eliminate much or all of federal USF for many carriers, SureWest is concerned that the radical changes proposed in the Plan could significantly destabilize the ability of those carriers to maintain their networks at current and prudent levels. In addition to concerns regarding the construction and maintenance of the network, SureWest urges the Commission to be mindful that overly rapid transitions to reduced ICC and USF cost recovery could also negatively impact the capital markets for carriers, which would further disrupt their ability to construct and maintain networks.

The Commission has in the past been mindful of the need to avoid disruptive transitions in ICC and USF:

Subscriber Plant Factor Reform: Sections 36.154(a) through (c) of the Commission's rules set forth procedures for allocating loop costs between the state and interstate jurisdictions. Prior to 1982, loop costs were allocated using a traffic sensitive interstate allocation factor known as the subscriber plant factor ("SPF").[11] By the early 1980's, increases in relative interstate usage caused carriers' interstate subscriber plant factors to escalate rapidly, reaching the maximum interstate cost allocation of 85 percent for some carriers. As a result, the Commission, in consultation with the Federal-State Joint Board,[12] instituted a flat-rate 25 percent interstate allocation factor to be phased in during an *eight-year* transition period, 1986 to 1993.[13] Concurrent with the institution of the new SPF transition period, the Commission established the universal service fund allowing ILECs with high local loop costs to allocate an additional portion of those costs to the interstate jurisdiction.[14] The universal service fund was phased in during the *same eight-year transition period* as the new subscriber plant factor. In order to ensure that a carrier's interstate cost allocation would not drop precipitously during the transition, the rules specified that the combined interstate factor, determined by considering the interstate subscriber plant factor and the universal service amount,

---

[11] *See,* 47 C.F.R. Part 67 (1980). The subscriber plant factors were determined by weighting toll minutes of use by factors greater than 1.0, weighting local minutes of use by 1.0, and determining the relative state and interstate proportions. Regardless of the relative proportions determined in this way, the rules limited the interstate subscriber plant factors to a maximum of 85 percent.

[12] *See,* 47 U.S.C. § 410; *Amendment of Part 67, Notice of Proposed Rulemaking and Order Establishing a Joint Board*, 78 FCC 2d 837 (1980).

[13] *See*, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order*, 89 FCC 2d 1 (1982) (adopting Joint Board's recommendation to freeze the subscriber plant factor at 1981 levels); *Decision and Order*, 96 FCC 2d 781 (1984) (adopting Joint Board's recommendation to establish a fixed 25 percent interstate allocation factor); *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, 50 Fed. Reg. 939 (1985) (revising the transition period to eight years with a limit of five percentage points reduction per year).

[14] *See,* 47 C.F.R. Part 36, Subpart F.

would decrease by no more than five percent in any one year.[15] Carriers with a very high subscriber plant factor were directed to extend their transition periods, subject to the five-percent limitation, until the 25 percent interstate allocation was reached.[16]

CALLS: In 2000, the Commission adopted the "CALLS Plan" to resolve major outstanding issues concerning access charges of price cap ILECs. The plan eliminated the Presubscribed Interexchange Carrier Charge (PICC), increased SLCs, and significantly revised the method for calculating price cap access charges, with the result of reducing those charges by $2 billion on a nation-wide basis.[17] The transition period enacted in that Plan was *five years*.[18]

The transition periods in both of the above cases reflect the need to cushion customers and carriers from unintended consequences of overly rapid transitions or precipitous shifts that could harm the public interest. The breadth and depth of impact on networks and subscribers proposed in the *NPRM* is significantly greater than that which the Commission created by enacting the SPF/USF changes and the CALLS Plan, and accordingly a proper transition period should be created to assure that networks are not adversely harmed and customers are not saddled with unexpected and harmful

---

15 *See, Amendment of Section 36.154 of the Commission's Rules, Memorandum Opinion and Order*, 6 FCC Rcd 1873, 1874 (1991).

16 *See, Amendment of Section 36.154 of the Commission's Rules, Memorandum Opinion and Order*, 6 FCC Rcd 1873, 1874 (1991).

17 *See*, *Access Charge Reform, Sixth Report and Order*, 15 FCC Rcd 12962, 12974-75 (2000).

18 *Id.* at 12985.

outcomes. In order to minimize disruption to the construction and maintenance of the network, a transition period of 7 to 10 years will be necessary.

V. The Commission Has Unique Responsibilities to Rate-of-Return Carriers in Modifying the USF/Intercarrier Compensation Regime.

As the Commission enacts USF/ICC reform, in addition to considering the general principles described above, it must also consider its unique responsibilities to rate-of-return ("ROR") carriers. While the majority of ILEC access lines are held by price-cap carriers, the majority of ILECs are regulated under ROR. These carriers are typically smaller, more reliant on regulated revenues, and thus more economically vulnerable to rapid and substantial shifts in regulation of their rates. Furthermore, federal law requires that ROR carriers be treated differently than price-cap carriers.

A. Federal Law Requires The Commission to Give Rate-of-Return Carriers a Realistic Opportunity to Recover Their Costs.

The Communications Act provides that the rates and practices of carriers subject to FCC jurisdiction must be just and reasonable, and free of undue discrimination or preference.[19] The primary responsibility for establishing rates lies with the carriers themselves. Each of them must file or join a tariff schedule with the Commission pursuant to Section 203(a) of the Act, and then charge customers accordingly.[20]

---

[19] 47 U.S.C. §§ 201(b), 202(a).

[20] 47 U.S.C. § 203(c).

The current state of federal law anticipates that the Commission must afford rate of return carriers a realistic opportunity for cost recovery.[21] It does not require a guarantee, but at the same time it does not tolerate a mechanism that is promoted as responsive to cost recovery on the surface but in fact systematically undermines the regulated business of the ROR carriers. The Commission's rules must not operate in a way that artificially pushes carriers' total return below a reasonable level. The Commission has some latitude, so long as the order "viewed in its entirety" allows a just and reasonable "total effect" on the regulated business.[22]

ROR carriers must have the opportunity to continue to operate as a viable provider of services. Even if the Commission elects to rely on section 251(b)(5) for its authority here, and even if it chooses in part to authorize the recovery of costs through the offsetting of reciprocal obligations, the Commission nevertheless cannot take action that effectively precludes affected ROR carriers from recovering in their rates all of those costs that are allowable for recovery under the Act.

The fact that the access rates of some ROR carriers have increased recently is not relevant to this particular analysis. The structure of the Act anticipates the ebb and flow of rates as demand and costs change. The rapid recent decline in access minutes of use necessarily requires that rates of affected ROR carriers be adjusted accordingly, pursuant to Commission rules. Carriers do not make impermissible earnings as a

---

[21] *See, Ohio Bell v. FCC*, 949 F.2d 864, 867 (6th Cir, 1991); *New England Tel. &Tel. v. FCC*, 826 F.2d 1101, 1109 (D.C. Cir. 1987). *See also, Duquesne Light Co. v. Barasch,* 488 U.S. 299 (1989).

[22] *AT&T v. FCC*, 836 F.2d 1386, 1391-92 (D.C. Cir. 1988) (citing *FPC v. Hope Natural Gas Co*., 320 U.S. 591, 602 (1944))(hereinafter, "*AT&T v. FCC*").

result, because if carriers do not raise their rates in such circumstances, they are unable to recover their costs.

In the past, the Commission has taken the position that the ROR access rates it has permitted allow adequate earnings, and carriers have generally accepted the Commission's assessment of the rates proposed, as well as the results of its review of anticipated revenues. In the *AT&T v. FCC* case, the Commission argued that the earnings it allowed to ROR carriers embodied the Commission's best estimate, in light of the evidence available to it, of the minimum earnings needed to retain the carrier's capital investors and to attract additional required investments.[23] Indeed, the Commission argued that properly set ROR rates would be the maximum allowable, thus balancing out investor and consumer interests. However, the *AT&T v FCC* case counsels that the Commission cannot ignore the impact of reducing ICC rates without considering and addressing the "systematic underearnings" that would necessarily result for ROR carriers absent alternative cost recovery accommodations.

In that case, the court overturned refund rules that introduced a "systematic bias" that depressed ROR carrier earnings over the long run.[24] The Court recognized that such a rule would actually operate over the long run to put an ROR carrier out of business. That result would not occur because of the business risk that a carrier is bound to accept under the accepted view that regulation does not guarantee the regulated company a profit. Rather, the court said, it was the Commission's own misguided rule that would improperly guarantee economic losses for ROR carriers.

---

[23] *AT&T v. FCC*, *supra* note 22, 836 F.2d at 1390.

[24] *Id.*

The *AT&T v. FCC* decision appears to require careful consideration here, so that the Commission can avoid a similarly prohibited result. If a ROR carrier's rates fall below the level required to allow recovery of all costs allowed to be included for calculation of a revenue requirement, each investor in that carrier loses, and such carriers will not be able to attract the investment necessary to build and maintain the robust broadband network sought by the Commission. Absent careful responsive action by the Commission, this situation could presents exactly the type of underearning inevitability found to be prohibited in the *AT&T* and *Ohio Bell* cases.

Thus, the Commission needs to accommodate the unique cost recovery needs of ROR carriers. A rate regulation is valid where it provides "ample protection" of a ROR carrier's cost recovery interests, according to the D.C. Circuit.[25]

Lastly, as a matter of procedure, the Commission should be mindful that it may not simply determine ICC rates, and for ROR carriers their authorized rates-of-return, through the present rulemaking proceeding. It is Section 205 that gives the Commission the authority to prescribe carrier rates and rates of return. As the D.C. Circuit has recognized, however, that authority is not unlimited. Pursuant to statutory requirements, the Commission may prescribe a rate only after a "full opportunity for hearing" and after determining that the rate to be prescribed will be "just and reasonable". *American Tel. & Tel. v. FCC*, 487 F.2d 865, 874 (2nd Cir. 1973) *citing, American Tel. & Tel. v. FCC, 449 F.2d 439, 450* (2 Cir. 1971). Such a hearing and

[25] *New England Tel. &Tel. v. FCC*, *supra* note 21, 826 F.2d at 1109. Alternatively, if the Commission is not going to allow ROR carriers to recover portions of their costs through ICC and USF, then it should consider complete deregulation of the rates of the ROR carriers. In that circumstance, they would be free to run their business like any other provider, taking their chances in the marketplace, rather than by the hand of the Commission.

finding are essential to any exercise by the Commission of its authority under Section 205(a). *Id.* Typically, rate prescription occurs in stand-alone proceedings, where rate-setting issues are explored in much greater detail than that set forth in the present *NPRM. See, e.g., Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers,* Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking*,* 13 FCC Rcd 20561 (1998). If the Commission chooses to prescribe interstate rates, and or re-prescribe rates-of-return for ROR carriers, it should initiate such a stand-alone proceeding.

In sum, the Commission must allow ROR carriers a realistic opportunity to recover their costs. Failure to do so would not only violate the Communications Act, it would also be arbitrary and capricious, and raise significant Fifth Amendment Takings issues as well.

B. <u>ICC Must Be Targeted Towards Cost Recovery.</u>

In the *NPRM*, the Commission discusses options for recovery mechanisms. Specifically, the Commission asks whether the mechanism should address <u>cost</u> recovery or <u>revenue</u> recovery.[26]

When the Commission determines whether rates filed with it are just and reasonable, it is <u>costs</u> that are generally the principal points of reference.[27] The law is clear: an ROR carrier must be permitted to charge rates that allow it to recover costs, along with a reasonable rate of return on its invested capital.[28] Of course, there is no

---

[26] *NPRM* at paragraph 564.

[27] *See, Ohio Bell v FCC*, *supra* note 21, 949 F.2d at 867.

[28] *Id*.

legal requirement to assure that affected carriers achieve certain revenue levels.

The *NPRM* seeks comments as to how the Commission should develop a cost standard.[29] The concept of costs for purposes of section 251(b)(5) may turn out to be different from the current concept of costs for purposes of sections 201-205 of the Act.[30] Presumably, the costs currently recognized in the access charge review process as being allowable for ROR ratemaking would not automatically become <u>un</u>allowable if some other form of ratemaking results from this proceeding. Those costs do not change simply by virtue of Commission fiat, and they should be viewed as presumptively acceptable.

The way that the Commission addresses those costs, however, is an open question. It is not clear whether the Commission intends to initiate a new review of costing, defining costs in a different way, or recognizing new forms of costs and discarding some old ones. If the Commission elects to explore those issues, it should do so in a separate proceeding in which those detailed and complex issues can be fully and properly evaluated. However, if the Commission elects to significantly modify its concepts of costs in this proceeding, and to exclude from ROR ratemaking any costs that are currently included, then an even longer glide path than currently considered in the *NPRM* will be necessary.

If the Commission elects here only to address interstate costs, then interstate rates must be set at the level required to allow recovery of those interstate costs. If the Commission elects to merge the treatment of access and reciprocal compensation

---

29 *NPRM* at paragraph 565.

30 *See generally Verizon v FCC*, 535 U.S. 467 (2002).

within one framework, then the combined charge must be set at the level sufficient to allow recovery of all of these costs, for both access and reciprocal compensation. And if the Commission elects to preempt the states or otherwise to merge the handling of access of interstate and intrastate calling purposes, with or without combination with reciprocal compensation, then the Commission must set access charges at the level sufficient to allow recovery of all of these costs, interstate and intrastate.

For switched access, the rules currently establish specific rate elements and require carriers to target the rates based on estimates of demand and other factors so as not to exceed the current authorized rate of return. Each of these rate elements is entitled to be targeted to earn enough revenues to cover costs and deliver a fair return. Applicable law does not allow the tradeoff of earnings from one element to another, so that overearnings from one element can be used by the Commission to shelter the chronic underearnings from another that it may cause.[31]

Further movement away from per-minute intercarrier compensation is not inherently precluded by the Communications Act or other principles. The Commission possesses such authority. At the time the Commission first put in place its framework for interstate access charges, one of its options was to forego any and all interstate cost recovery through per minute rates, and instead to recover those costs solely through flat charges assessed on all customers for interstate services. This option was an option described as “pure”, in part because some parties argued that the costs of the nationwide network were no longer sensitive to the volume of traffic carried on it, and thus the optimum avenue for economic cost recovery would be through fixed charges

[31] *See, AT&T v. FCC*, *supra* note 22, 836 F.2d at 1391.

alone. Even then, cost causation principles supported at least one option that was purely flat rate in nature.[32]

However, the Commission determined at that time that the implementation of a rate structure using only flat-rate-based cost recovery was not in the public interest, and that there were other significant factors that required that the Commission choose a "mixed" path instead, recovering interstate costs through a balance of minute-of-use and flat charges on end users.[33] This arrangement has served the public interest well.[34]

In sum, for so long as the Commission maintains comprehensive oversight over the rates of ILECs, it cannot fail to offer to rate of return carriers a realistic opportunity for each of those carriers to recover the costs that they have incurred, however the Commission has elected to recognize those costs.

If, however, the Commission chooses to base ICC on the recovery of revenues, then it should also be careful not to "cheat" – that is, to take into account for regulated cost recovery purposes the non-regulated revenues and non-jurisdictional revenues that

[32] *See NPRM* at paragraph 525.

[33] *See, Third Report and Order, MTS-WATS Market Structure*, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 (1983); mod. on reconsideration, 97 FCC 2d 682 (1983) ("*First Reconsideration Order*"); mod. on further reconsideration, 97 FCC 2d 834 (1984) ("*Second Reconsideration Order*"); affirmed on further reconsideration, 101 FCC 2d 1222 (1985) ("*Third Reconsideration Order*"); affirmed but remanded on other issues, *NARUC v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984); affirmed, *AT&T v. FCC*, 832 F.2d 1285 (D.C. Cir. 1987).

[34] In the *NARUC* opinion, the Court was careful to state explicitly: "Our conclusion today that the Commission may lawfully impose flat-rate end user access charges on a gradual basis in order to preserve universal service is premised on the holding that rates may be structured to avoid disruptive service impacts." *NARUC*, *supra*, 737 F.2d at 1135.

it has always prohibited from commingling for other purposes.[35] The *Hope Natural Gas* case counsels that in such a context the Commission must address only regulated revenues (i.e., looking at the "total effect" on the *regulated* business).[36] Therefore, taking into account the revenues from across all services – regulated and non-regulated -- on multi-purpose networks for the purpose of evaluating the legitimacy of reducing regulated rates for access here would be inappropriate, and would not be fair to carriers.

C. ICC Rates Must be Rationally Based on Data and Models.

SureWest sees the Commission's election to begin to collect information related to the switched access revenues, expenses and minutes of use of carriers, including the rate of return carriers, as a significant positive action, presumably so that it can run simulations and test alternatives before action. When it last made major changes in the interstate access charge structure and rates (in the CALLS and MAG proceedings), the Commission removed certain implicit subsidies from interstate charges and made them explicit, causing the costs involved to be recovered through a mix of increased subscriber line charges and a new universal service mechanism. The rates that were ultimately prescribed there by the Commission, however, and the allocation of cost recovery between carriers and end users, were in large part driven by industry compromise, rather than any formal bottom-up rate case or detailed carrier-by-carrier cost analysis.

The individualized rates in place today that apply to interstate access remain fair and cost-based because of the rigor of the access tariff filing and review process.

---

35 See, for example, the Commission's Part 65 cost allocation rules.

36 *FPC v. Hope Natural Gas Co*., *supra* note 22, 320 U.S. at 602.

There may be many variations in access rates, but with a few exceptions none are inherently unreasonable – rather, they are based on costs as they are defined by Commission rules. Unfortunately, some parties have called for an ICC rate level of $0.0007 cents per minute, although that rate is a scarcely-justified figure that has never been identified as the rate actually needed for ROR carriers (or others) to recover their costs. The original adoption of $0.0007 was a reflection of a single interconnection agreement at a single point in time, namely, Level 3's interconnection agreement with SBC for 2002.[37] As Level 3 and SBC have no resemblance to ROR carriers, the $0.0007 rate has no obvious or apparent applicability to ROR cost recovery requirements. A rate at that level is highly likely to be insufficient to allow ROR carriers to recover their costs, absent some other recovery method. That is certainly the case for SureWest's rate of return interstate access rate elements. Rather, a rate higher than $0.0007 will be required. Once the Commission has solidified many of the other open issues in this proceeding that would impact cost recovery, then carriers can be in a better position to provide information as to what those rates should be.[38]

D. The Commission Should Act Carefully Not to Impair The Critical Cost Recovery Function of ICLS.

In a number of places in the *NPRM*, the Commission seeks comments on the treatment of interstate common line support ("ICLS"). In light of the critical role played by ICLS in allowing carriers to recover costs while keeping rates as close as possible to being cost-based, SureWest urges the Commission to act carefully in fitting ICLS into its

[37] *Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9190 (2001).

[38] However, as discussed above, rates should be set in a separate rate re-prescription hearing.

on-going USF policies, both during the transition to and after the full implementation of the CAF.

In the *MAG* proceeding, the Commission created a new, explicit universal service support mechanism, ICLS, to replace implicit support in the access rate structure of rate-of-return carriers. As the Commission has noted, "ICLS replace[d] the carrier common line charge, and thereby permits each carrier to recover its common line revenue requirement, while ensuring that its subscriber line charges remain affordable to its customers. This makes possible the reduction of per-minute access rates toward cost-based levels, which in turn encourages the provision of affordable and competitive long-distance services in rural areas."[39] As such, this important function of ICLS should not be significantly impaired.

Specifically, while it may be reasonable to cap the current level of ICLS, such capping should be on a dollar basis per study area, not on a per-line basis. It is important to recognize that while traditional access lines may be declining, the common line costs in fulfilling the COLR obligation to provide service to the existing subscribers does not go down incrementally on a per-line basis. Accordingly, the cost recovery mechanism of ICLS should not be capped in that manner. Similarly, caps for

[39] *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Third Order on Reconsideration, 18 FCC Rcd 10284, 10285 (2003)(internal citations omitted).

application of ICLS to operating expenses and capital expenses should also be on a dollar basis per study area.[40]

Finally, ICLS should not be subject to any USF reverse auction mechanisms. ICLS is core to recovering the fixed costs of COLR service which are unique to each individual carrier, and those costs do not disappear in the presence of competitors.

VI. Conclusion

The construction and maintenance of advanced ILEC networks is critical to the accomplishment of the Commission's goals in the National Broadband Plan. However, proposals to shift all of the cost recovery necessary for such networks onto terminating end users, without some alternate recovery mechanism, is contrary to the public interest. The Commission also has unique responsibilities towards ROR companies in the process of revising the USF/intercarrier compensation regime, and must allow those companies a realistic opportunity to earn their authorized rate of return.

Respectfully submitted,

SUREWEST COMMUNICATIONS

By: *__/s/ Paul J. Feldman__*
Paul J. Feldman
Its Attorney

FLETCHER, HEALD & HILDRETH, PLC
1300 North 17th St.
11th Floor
Arlington, Virginia 22209
(703) 812-0400

April 18, 2011

---

[40] By the same token, while it may cap the amount of corporate operations expenses recoverable from ICLS, it is not reasonable for the Commission to eliminate such recovery. Such expenses are legitimate costs of providing service, and have been recognized as such by the FCC (*see* 47 C.F.R. 69.409) as well as state regulators. Again, corporate operation costs do not go away, and to the extent that they are not recoverable through ICLS and other USF mechanisms, they must be recovered otherwise.